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The New Hampshire BANKING DEPARTMENT NEWSLETTER

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FROM THE COMMISSIONER'S DESK

As I write these words, spring may finally have arrived at the Banking Department. I certainly am ready for spring! After a late start, winter certainly made itself felt. Since March came in like a lion, I hope it will go out like a lamb.

It has been a busy few months since the last newsletter. The legislative session is in full swing. As a result, I and others from the Department have been spending a lot more time at the State House and Legislative Office Building! Of course, the regular work of the Banking Department continues in spite of the legislative agenda.

Finally, I was pleased that Governor Lynch nominated me for a second term as Commissioner. There have been a lot of positive changes in the Department during my first term. We won't be resting on our laurels, however. Expect more changes during the next six years. And, be warned: that means I will be writing these comments until January 1, 2013 (at least!).

Enjoy the spring!

Commissioner Hildreth Reappointed

On January 10, 2007, Governor John H. Lynch nominated Commissioner Peter C. Hildreth for a second term. The Governor's Council voted 4 to 0 to confirm the nomination for a term that expires January 1, 2013. On February 6th, Secretary of State William Gardner administered the oath of office to Commissioner Hildreth. The informal ceremony was attended by members of the Banking Department staff as well as the Commissioner's wife, Holly Hildreth.

At the start of his second term, Commissioner Hildreth stated, "I am proud of what we have accomplished at the Banking Department over the last 5 ½ years. I am looking forward to the challenges and opportunities we will meet in the next 6 years."

Hildreth, a graduate of Franklin Pierce Law Center and Plymouth State University, was first appointed in September 2001 by then Governor Jeanne Shaheen. He is a member of the Board of Directors of the Conference of State Bank Supervisors (CSBS). He was recently selected as Chairman of CSBS District One. He resides in Concord with his wife Holly and their two daughters.

Newsletter Update

This will be the last newsletter published and distributed by the Department. Production costs and technology have precipitated this change. We will send out an email notice when the Newsletter is available on our web site. If you would like to be placed on the email list, please send an email to newsletter@banking.state.nh.us and put "Newsletter" in the subject line.

Department Web Site Changes

The Department's web site has been completely renovated recently. We have made it more user friendly both for the entities we regulate and the consumers. So log on, take a look, and let us know what you think and how we can improve it. One of the most significant changes to the web site is the posting of the Department public enforcement actions. Since the beginning of this year, the Department has been posting enforcement actions, as well as declaratory actions of the Commissioner. So, check it out and let us know what you think.

New Personnel in the Banking Department

Jennifer McAllister has joined the Department staff as a Paralegal in the Consumer Credit Division.

Escrow Rate

The escrow rate for the period February 1, 2007 through July 31, 2007 is 1.16%.

BANKING DIVISION NEWS

Charles M. O'Connor – Chief Bank Examiner

New State Chartered Entities

The Bank Commissioner authorized two new non-depository trust companies to commence business – AllianceBernstein Trust Company, LLC on January 30, 2007 and Loomis Sayles Trust Company, LLC on February 13, 2007.

Electronic Notification of Suspicious Activity Reports (SAR)

By Robin Boman, Bank Examiner

A reminder to banks, credit unions, and trust companies of a prior change to reporting requirements –

New Hampshire RSA 384:36 – Reports of Proscribed Activity requires state chartered financial institutions to concurrently file with the Department a SAR when it is filed with the institution's federal regulator.

Oath of Office – William Gardner, Peter Hildreth, and Holly Hildreth

State chartered institutions who submit SAR(s) to FinCEN may notify the Department of their SAR filing(s) by connecting to the link "Notice of FinCEN Filing" found on the Department web site under the Banking tab. The content of the SAR is not reported in detail on the form. Electronically notifying the Department of a SAR filing will eliminate the need to file a paper copy of the SAR. For greater efficiency and security, if possible, you are encouraged to use this method of reporting. Once the "notice" is filed, authorized NHBD personnel will be alerted and able to review the filing on FinCEN's secure outreach gateway.

If you do **not** notify the Department electronically of the SAR filing, you must forward a hard copy of the SAR to the Department.

Risk-Based Audit

By Parker Howell, Bank Examiner

Perhaps the area within the IT examination that needs the most improvement is the Audit component rating, as some institutions seem to struggle with the concept of a risk-based audit function. The FFIEC guidance is very clear and very simple: "…establish an effective risk-based audit function…" In short, allocate your audit resources to the areas of highest risk. To do this you must first determine risk levels for all areas that need audit coverage.

Determine Risk Levels

To determine a risk level you need to complete an audit risk assessment. First, identify all IT areas and systems that may need audit coverage. This may include hardware, data operating systems, applications, telecommunication lines etc. Second, apply a risk scoring system to each area to determine each risk level.

A risk scoring system incorporates several factors that are used to determine the level of risk. Risk levels may be defined as high, medium, or low. Factors used in the scoring system may include, the nature of transactions, the age of the system or application, the nature of the operating environment, the adequacy of management oversight, and previous regulatory and audit results, to name a few. These factors should determine the risk level for each area.

Develop an Audit Plan

Once you have determined risk levels you are ready to develop a 3 to 5 year audit plan. The frequency of audits should be predetermined based upon risk. For instance, high-risk areas would be audited every 12-18 months, medium risk areas 18-30 months and low risk areas every 30-36 months. Since risk levels and audit frequency are predetermined, developing an audit plan should be relatively straightforward. Of course, this plan is a moving target and each year you should readjust the plan based upon changes and prior audit results.

A risk-based audit program not only applies to IT but should apply to all areas of the institution as well. If you need more guidance, see the FFIEC Information Technology Audit handbook at www.ffiec.gov.

NOTICE

This will be the

LAST NEWSLETTER

printed and distributed

via u.s. mail

by the

NEW HAMPSHIRE

BANKING DEPARTMENT

Please read the article
***Newsletter Update* in this issue!**

Quarterly Off-site Banking Review

By Todd Wells, Bank Examiner

As reported in a prior newsletter, the New Hampshire Banking Department initiated a quarterly off-site review process for banks in early 2004. This analysis is designed to identify financial trends among the universe of banks examined by the Department. The analysis focuses on approximately 30 ratios and measures that correspond to the various financial components evaluated at each examination: capital, asset quality, earnings, liquidity, and sensitivity to market risk. The primary data source is Call Reports/Uniform Bank Performance Reports.

Observation of Deposit Trends

The December 2005 review noted deposit outflows in nearly half of the institutions examined with most of the deposit reductions occurring after September 2005. While the overall volume of deposit outflow was not deemed substantial, the trend was significant compared to the deposit growth pattern of several prior years.

The quarterly off-site banking review performed as of March 2006 observed minimal deposit outflows from the prior quarter while the June 2006 review observed overall deposit growth (with only a few institutions experiencing runoff) from the prior quarter.

The September 2006 review noted renewed deposit runoff in nearly half of the institutions examined. The trend and stability of deposits is an important factor in assessing liquidity. Management/ALCOs should thoroughly evaluate any meaningful changes in funding sources; consideration should be given to seasonality, changes in market conditions, competition, etc. Good management information systems, strong analysis of funding requirements under alternative scenarios, diversification of funding sources, and contingency planning are crucial elements of strong liquidity management.

Credit Unions and Member Business Loans

By Denise St. Pierre, Bank Examiner

Member Business Loans (MBLs)…do we or don't we? That's the question credit unions may be asking themselves, do we offer them or not? There are benefits and risks associated with MBLs; opportunities for new members/relationships, loan income and higher regulatory scrutiny, just to name a few. Credit unions offering MBLs must comply with NCUA Rules and Regulations Part 723 Member Business Loans. A board approved MBL Policy must be in place that, at a minimum, meets all the requirement of Part 723. Some credit unions may look to third party providers to underwrite MBLs for the credit union. Key words for this type of arrangement are "Due Diligence"! Credit unions that offer MBLs in this manner should have a contract in place with the third party provider. The contract should state the responsibilities and rights of each party, also addressing who/how Bank Secrecy Act requirements will be met. The credit union must have someone in-house who can properly review and analyze the loan documents prior to and subsequent to origination. While understanding the reason for looking to a third-party to comply with the regulation's experience requirement (723.6(f)), outsourcing does not negate the need for in-house personnel to be able to thoroughly understand the loan. Unless purchased with recourse, the loan becomes the credit union's responsibility regardless of who underwrote it.

Remember, the three most important things about MBLs; Document, Document, and Document! Management needs to obtain all documents related to the loan (i.e. note, mortgage, appraisal, environmental assessment). All documentation received from the borrower(s) and/or guarantor(s) needs to be signed (i.e. applications, financial information). Their signature attests to the authenticity of the documents. While the third party may provide a loan offering/approval memorandum discussing all areas, this memorandum is based on the judgment and assumptions of the author. The supporting documents on which this memorandum is based should be reviewed by credit union personnel. Any and all actions/discussions involving an MBL should be thoroughly documented. Documentation attests to management's understanding and evaluation of the credit. For additional information please refer to NCUA Rules and Regulations Part 723.

CONSUMER CREDIT DIVISION NEWS

Mary L. Jurta – Director of Consumer Credit

On-Line Annual Report Filing

For the first time the Department offered the ability to file annual reports electronically. Of the 1,050 annual reports filed to date, 671 were filed electronically. The Department is in the process of reviewing all the annual report fillings (both electronic and paper) to ensure they are accurate. You might receive, if not already, a letter from the Department seeking clarifications or corrections on the report.

Access to Funds at Closing

As you all know, there are a number of serious problems within the sub prime industry right now. The number one issue, as far as the Department is concerned, is the availability of funds at closing. There have been some instances in this state and across the nation where loans were closed without the funding being in place. This is a violation of New Hampshire law and forces the Department to take enforcement action. In placing a loan with a wholesale lender, please ensure that they have financial wherewithal to close the loan. In addition, if information comes to light that the entity has exhibited an inability to potentially fund a loan, please take alternative actions to ensure the protection of the consumer in the transaction.

Protection of Consumer Information

In May of 2003 the Federal Trade Commission promulgated rules with respect to the treatment of consumer information. As we have mentioned in past Newsletters, the Department is applying those standards as part of the examination process. That review runs the gambit of information delivery systems and storage of information, both in paper and electronic forms.

The Federal Trade Commission (FTC) promulgated "Standards for Safeguarding Customer Information" (16 CFR 314). These rules (which became effective May 23, 2003) implement sections 501 and 505(b)(2) of the Gramm-Leach Bliley Act. These rules apply to all financial institutions over which the FTC has jurisdiction. For the NHBD Consumer Credit Division, that is all of our licensees.

In general, each company must have a written information security program that is readily accessible and contains administrative, technical, and physical safeguards that are appropriate to the size and complexity of your business. Please review the Spring 2004 Department Newsletter for information and other pointers. At this point all companies should be in compliance with these regulations.

After the Examination

Once an examination is complete, the examiner in charge prepares an examination report. An invoice for the examination is prepared. The charges include a per diem rate for each day that each examiner was working on the examination. By statute, there is a minimum charge of one full examiner day. The report and bill are sent to the licensed company.

The statute allows the company 30 days, after it receives the report, to review the report and recommend in writing any changes to the report, if the company feels there are factual inaccuracies. The company's written response needs to be received by the Banking Department on or before the 30th day. Where the examiner has observed a violation of state or federal law or rules, the company should indicate the remedial action it will take to correct the situation. The company should be aware that this 30 day period is its only opportunity to recommend changes or raise issues with the report before the report becomes legally final and accepted. A company may choose not to respond to the examination and in that case, the report automatically becomes final and accepted after the expiration of the 30 day period.

Once the company's written response has been received and reviewed by the Department, one of several things may happen:

- Based on additional facts provided to the Department by the company, the report may be changed to correct factual information. When a report is modified, the company has an additional 30 day review period.
- Where the report is determined to be factually accurate, the Department will decline to make any changes to the report. A letter will be sent to the company indicating that its response has been received and reviewed and will be incorporated into the file as part of the record, but that no changes will be made to the report. If no enforcement action is contemplated, there will be a note on the letter indicating that the Department has closed its file in the matter.
- The company may request a closed hearing on the matter so long as the request is made within 30 days from the date the company receives the report.
- When the company offers remedial actions to correct observations and deficiencies noted in the report, and the actions are determined to resolve the issues, the letter will be made part of the record and subsequent Banking Department examinations will verify that the actions undertaken by the company are in place and effectively solving the problem. A letter will be sent to the company indicating that its response has been received and reviewed and will be incorporated into the file as part of the record, but that no changes will be made to the report. If no enforcement action is contemplated, there will be a note on the letter indicating that the Department has closed its file in the matter.
- Whenever a violation of state or federal law is observed in a report, the Department weighs both the degree and seriousness of the violation, including its impact on consumers and the industry and the company's response, including its initiation of corrective measures against the Department's enforcement obligations. Repeated violations and violations of a serious nature may result in an enforcement action. If the Department feels that an enforcement action is warranted, it will initiate an action after the report is finalized and accepted by the Commissioner.

Each examination is unique and each report is evaluated on an individual basis. The above procedures represent the general criteria used by the Department, but special circumstances and information subsequently learned by the Department may dictate another course of action.

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